

No. 12456.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ESTATE OF R. L. LANGER, Deceased; ELEANORE LANGER,
Executrix; ELEANORE LANGER; C. ABBOTT LINDSEY;
and PAULINE LINDSEY,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR PETITIONERS.

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vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR PETITIONERS.

Jurisdiction.

This petition for review involves deficiencies in Federal income taxes of petitioners, Estate of R. L. Langer, deceased; Eleanore Langer, executrix, and Eleanore Langer for the calendar year 1944, and of petitioners C. Abbott Lindsey and Pauline Lindsey for the calendar years 1944 and 1945 as follows:

<u>Petitioner</u>	<u>1944</u>	<u>1945</u>
Estate of R. L. Langer,		
Eleanore Langer, Executrix	\$3,086.48	\$
Eleanore Langer	3,099.96	
C. Abbott Lindsey	2,041.07	2,867.32
Pauline Lindsey	2,041.07	2,867.32

[Tr. 103]

The cases of the four petitioners involve identical issues and were presented to and heard by The Tax Court of the United States (hereinafter referred to as the "Tax Court") pursuant to the provisions of Section 272 of the Internal Revenue Code (26 U. S. C. A., Sec. 272). The cases were consolidated for hearing before the Tax Court. [Tr. 84.] The decisions of the Tax Court determining said deficiencies were entered September 29, 1949. [Tr. 98-101.]

This petition for review was filed on or about December 6, 1949 [Tr. 105-106] pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code (26 U. S. C. A., Secs. 1141 and 1142).

Opinion Below.

The only previous opinion rendered in this cause is the opinion of the Tax Court [Tr. 85-97] reported in 13 T. C., No. 59.

Issue Involved.

But one issue is involved in the proceeding:

Did respondent err in determining that amounts received by petitioners during the years 1944 and 1945 (with respect to petitioners, Estate of R. L. Langer, and Eleonore Langer, only the year 1944 is involved), which amounts constituted compensation for services rendered by petitioners prior to said taxable years, were not "back pay" as defined in Section 107(d)(2)(A) of the Internal Revenue Code (26 U. S. C. A., Sec. 107(d)(2)(A)), taxable in the manner prescribed in Section 107(d)(1) of the Internal Revenue Code (26 U. S. C. A., Sec. 107(d)(1))?

Statutes and Regulations Involved.

INTERNAL REVENUE CODE (26 U. S. C. A.):

“Section 107(d)(1). IN GENERAL.—If the amount of the back pay received or accrued by an individual during the taxable year exceeds 15 per centum of the gross income of the individual for such year, the part of the tax attributable to the inclusion of such back pay in gross income for the taxable year shall not be greater than the aggregate of the increases in the taxes which would have resulted from the inclusion of the respective portions of such back pay in gross income for the taxable years to which such portions are respectively attributable, as determined under the regulations prescribed by the Commissioner with the approval of the Secretary.

“(2) DEFINITION OF BACK PAY.—For the purposes of this subsection, ‘back pay’ means (A) remuneration, including wages, salaries, retirement pay, and other similar compensation, which is received or accrued during the taxable year by an employee for services performed prior to the taxable year for his employer and which would have been paid prior to the taxable year except for the intervention of one of the following events: (i) bankruptcy or receivership of the employer; (ii) dispute as to the liability of the employer to pay such remuneration, which is determined after the commencement of court proceedings; (iii) if the employer is the United States, a State, a Territory or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any of the foregoing, lack of funds appropriated to pay such remuneration; or (iv) any other event determined to be similar in nature under regulations prescribed by the Commissioner with the approval of the Secretary; and (B) wages or salaries

which are received or accrued during the taxable year by an employee for services performed prior to the taxable year for his employer and which constitute retroactive wage or salary increases ordered, recommended, or approved by any Federal or State agency, and made retroactive to any period prior to the taxable year; and (C) payments which are received or accrued during the taxable year as the result of an alleged violation by an employer of any State or Federal law relating to labor standards or practices, and which are determined under regulations prescribed by the Commissioner with the approval of the Secretary to be attributable to a prior taxable year. Amounts not includible in gross income under this chapter shall not constitute 'back pay'."

REGULATIONS III:

"Sec. 29.107-3. BACK PAY ATTRIBUTABLE TO PRIOR TAXABLE YEARS.—Section 107(d)(2) defines 'back pay' and section 107(d)(1) limits the amount of tax resulting from the inclusion of such back pay in gross income for the year in which it is received or accrued. Back pay includes compensation, wages, salaries, pensions and retirement pay received or accrued during the taxable year by an employee for services performed prior to the taxable year for his employer and which would have been paid prior to the taxable year but for the intervention of any one of the following events: (1) bankruptcy or receivership of the employer; (2) dispute as to the liability of the employer to pay such remuneration, which is determined after the commencement of court proceedings; (3) if the employer is the United States, a State, a Territory, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any of the foregoing, lack of funds

appropriated to pay such remuneration; or (4) any other event determined to be similar in nature under these regulations. As to what constitutes bankruptcy and receivership proceedings see section 29.274-1.

“An event will be considered similar in nature to those events specified in section 107(d)(2)(A)(i), (ii), and (iii) only if the circumstances are unusual, if they are of the type specified therein, if they operate to defer payment of the remuneration for the services performed, and if payment, except for such circumstances, would have been made prior to the taxable year in which received or accrued. For the purposes of this section the term ‘back pay’ does not include remuneration which is deemed to be constructively received in the taxable year or years in which the services were performed, remuneration paid in the current year in accordance with the usual practice or custom of the employer even though received in respect of services performed in a prior year or years, additional compensation for past services where there was no prior agreement or legal obligation to pay such additional compensation, or any amount which is not includible in gross income under chapter 1.”

Summary of the Case.

This proceeding was submitted to the Tax Court on the pleadings, a partial stipulation of facts, oral testimony offered by the petitioners, and exhibits introduced in evidence at the hearing.

Between January 1, 1937, and December 31, 1945 (as well as prior and subsequent to said dates), R. L. Langer (herein referred to as “Langer”) and C. Abbott Lindsey (herein referred to as “Lindsey”) were officers and em-

ployees of Commodore Hotel Co., Ltd., a California corporation (herein referred to as "Commodore"), which owned and operated the Commodore Hotel in the City of Los Angeles, California. [Tr. 88.] By a corporate resolution dated April 14, 1937, Commodore undertook to pay to Langer and Lindsey a salary of \$600 per month each from January 1, 1947, and every month thereafter. Pursuant to this resolution, there was paid to each a total of \$4800 during the calendar year 1937. No further payments of salary were made by Commodore to either Langer or Lindsey until 1943. [Tr. 88.]

In each of the years 1933 through 1941, Commodore sustained operating losses, and its balance sheets continuously showed a deficit. [Tr. 88.]

During all of said years, Commodore's principal assets, its hotel building and furnishings, were subject to a deed of trust and chattel mortgage to secure a promissory note payable to Pacific Mutual Life Insurance Co. (herein called "Pacific") in the principal amount of approximately \$250,000. In January, 1937, Commodore was delinquent in payment of interest and principal on said note, and Pacific had advanced additional funds to Commodore for the payment of property taxes. In January, 1937, a new note was executed in the principal amount of \$255,000, representing the balance then due to Pacific, which note provided for payments in monthly installments. Commodore anticipated improved business conditions, which, it thought, would enable it to pay the authorized salaries. Commodore thereafter made payments on said note, but payments again, in 1937, began to be late (constituting default), and Pacific made further advances to Commodore on account of property taxes.

By August, 1941, the amount due to Pacific had been reduced only to \$240,750. In September, 1941, the note was again rewritten, reducing the interest rate and extending the payment period. [Tr. 88-89.]

Commencing in January, 1943, Commodore resumed payments of salaries of \$600 per month each to Langer and Lindsey. Commodore realized operating profits in 1942 and 1943, after making required payments on the indebtedness to Pacific. [Tr. 90.]

In January, 1944, Commodore, by resolution of its board of directors, authorized payment of back salaries to Langer and Lindsey as rapidly as the financial condition of the corporation would permit. Pursuant to said resolution, Commodore paid \$10,000 each to Langer and Lindsey in 1944 on account of back salary. In 1945, Commodore paid \$11,500 to each on account of back salary. [Tr. 90.] These payments were in addition to regular current monthly salaries which were paid.

In their separate tax returns for the year 1944, Langer and wife and Lindsay and wife each reported \$5000 as his community share of the \$10,000 paid to each husband during that year and each computed his tax on these amounts at the rates applicable to the years for which the salary was paid, invoking the benefits of Section 107(d) of the Internal Revenue Code (26 U. S. C. A., Sec. 107(d)). Lindsey and wife each reported \$5750, and computed the tax thereon similarly, for 1945. [Tr. 91-92.] Section 107(d) provides, in effect, that if a salary earner does not, for specified reasons beyond his control (including bankruptcy or receivership of his employer, or an event similar in nature thereto), receive his compensation in the year in which he renders services, but

later receives it, he shall not be required to pay an income tax thereon in the year of receipt greater than he would have had to pay had he received the compensation in the earlier year.

Respondent determined that Section 107(d) of the Internal Revenue Code was not applicable and not properly invoked by petitioners in the computation of their Federal income tax liability for the years 1944 and 1945; and he determined deficiencies accordingly. [Tr. 93.] Petitioners filed petitions in the Tax Court, alleging error on the part of respondent in this determination. [Tr. 2-83.] The Tax Court, through Judge Johnson, decided in favor of respondent. [Tr. 97.] The Tax Court concluded that Commodore's failure to pay the full salaries authorized for 1937, and to pay any salary for the years 1938 through 1942, was the consequence of a restraint voluntarily imposed upon itself by the corporation; and that there was no legally enforceable restriction upon such payments. It then concluded that a legally enforceable control in someone other than the taxpayer is the essential characteristic of bankruptcy or receivership in order to bring the case within the orbit of Section 107(d)(2) of the Internal Revenue Code. Having reached said conclusion, the Tax Court failed to make any findings or conclusions as to the other contentions of the parties in support of their respective positions. [Tr. 95-97.] The Tax Court having sustained the respondent's determination, this petition for review was filed by petitioners.

Specification of Errors.

(1) The Tax Court erred in its finding that the failure of Commodore to pay full officers' salaries authorized was the consequence of a restraint voluntarily imposed upon itself by said corporation.

(2) The Tax Court erred in its conclusion that factual necessity restricting a corporation's freedom of action, resulting from serious financial difficulties rendering payment of officers' salaries impossible if corporate operations are to continue, is not an event similar in nature to bankruptcy or receivership.

(3) The Tax Court erred in its conclusion that the existence of a legally enforceable control in another is the essential characteristic of bankruptcy or receivership, and that, for purposes of Section 107(d) of the Internal Revenue Code (26 U. S. C. A., Sec. 107(d)), an event cannot be similar in nature to bankruptcy or receivership if such element of control does not exist.

(4) Assuming, but not conceding, that the Tax Court did not err in its conclusion that the existence of a legally enforceable control in another is the essential characteristic of bankruptcy or receivership, nevertheless the Tax Court erred in its finding or conclusion that such control in another did not exist in this case.

Summary of Argument.

In the trial of the cases below, the respondent advanced three theories in support of his determination that the provisions of Section 107(d) of the Internal Revenue Code (26 U. S. C. A., Sec. 107(d)), were not properly invoked by petitioners. [Tr. 87.] The Tax Court passed upon only one thereof, namely, whether or not the deferment in payment of salaries was caused by an event similar in nature to bankruptcy or receivership; and having decided said point adversely to petitioners, found it unnecessary to consider respondent's other theories. [Tr. 97.] Therefore, on this appeal, the only question for consideration is whether or not the event which caused deferment in payment of the salaries was similar in nature to bankruptcy or receivership.

The contentions of petitioners are as follows:

(1) During the period from September 1, 1937, through December 31, 1941, Commodore was in a financial and operating condition similar in nature to bankruptcy or receivership within the meaning of Section 107(d) of the Internal Revenue Code. This event or condition, but for the existence of which the payments would have been made, necessitated the deferment of payment of authorized salaries to Langer and Lindsey.

(2) Pacific, by virtue of the secured obligation of Commodore to it, effectively controlled the operations of Commodore. The existence of this control was

sufficient to satisfy the requirements of Section 107(d) of the Internal Revenue Code.

(3) Assuming, without conceding, that the Tax Court's conclusion that a contractual or "legal" restriction upon the payment of officers' salaries is required in order to bring this case within Section 107(d) of the Internal Revenue Code, such restriction existed in this case, and should have been recognized as a proper foundation for the application of said section.

Outline of Argument.

A. The deferment in payment of salaries to Langer and Lindsey was the consequence of an event similar in nature to bankruptcy or receivership.

B. The control exercised by Pacific over the operations of Commodore was sufficient to satisfy the requirements of Section 107(d) of the Internal Revenue Code, and the deferment of payment of the salaries was not the result of a voluntary restraint.

ARGUMENT.

A. The Deferment in Payment of Salaries to Langer and Lindsey Was the Consequence of an Event Similar in Nature to Bankruptcy or Receivership.

The Tax Court, in its findings of fact and opinion [Tr. 85-97], found as facts:

(1) That from 1933 until 1942, Commodore each year sustained operating losses, and its balance sheets constantly indicated a deficit. [Tr. 88.]

(2) That the net deficit reached a maximum of \$63,867.69 in 1941. [Tr. 88.]

(3) That in 1937 Commodore was not only delinquent in the payment of interest on its note to Pacific, but Pacific had advanced funds for taxes on the hotel property [Tr. 88]; and that between January 16, 1937, and June 30, 1939, Commodore was delinquent in payment of monthly installments on the note, and Pacific had had to make further advances for taxes on the hotel property. [Tr. 88-89.]

(4) That for the period in which the authorized salaries were not paid, Pacific was in a position to foreclose on the hotel and furnishings at any time [Tr. 95]; and that very cogent circumstances deterred Commodore from paying any salaries during the period of financial distress.

(5) That Pacific refrained from foreclosure because its officers were of the opinion that Commodore's properties were being capably and honestly handled by Langer and Lindsey. [Tr. 89.]

(6) That such forbearance would not have been shown had Commodore increased its operating losses by annual payments of \$14,400 as salaries to Langer and Lindsey. [Tr. 95-96.]

Notwithstanding these clear findings of fact, the Tax Court decided that no legal restriction of Commodore's freedom of action existed, and that in the absence of such legal restriction, the event may not be deemed to be similar in nature to bankruptcy or receivership within the meaning of Section 107(d) of the Internal Revenue Code. The Tax Court found the existence of what it referred to as *factual necessity* which restricted Commodore's freedom of action, but nevertheless concluded that failure to pay salaries to Langer and Lindsey was the consequence of a restraint voluntarily imposed. Passing for the moment any discussion of the obvious contradiction between the Tax Court's conclusion and its finding just stated, it is apparent that the Court has misconceived the meaning of the phrase "similar in nature to" bankruptcy or receivership.

Webster's New International Dictionary, Second Edition (G. and C. Merriam Co., 1947), defines the word "similar" as follows:

"Nearly corresponding; resembling in many respects; somewhat like; having a general likeness."

The same authority defines "receivership," "receiver," "bankruptcy," and "bankrupt," as follows:

Receivership: "The state or condition of being in the hands of a receiver; as, to put a corporation into, or under, receivership."

Receiver: "A person appointed, ordinarily by a court of equity jurisdiction, to receive, and hold in trust, money or other property which is the subject of litigation, pending the suit, as in case of a person incompetent to manage his property, or of the dissolution and winding up of a partnership or a corporation, etc. The receiver is an officer of the court, and the property held as such by him is not subject to process other than in the case itself. He often obtains authority to continue and manage the business as a going concern."

Bankruptcy: "State of being *actually* or legally bankrupt; a becoming bankrupt." (Emphasis added.)

Bankrupt: "Any person whose property becomes liable to administration under the bankrupt laws. Under the first bankrupt laws (which were directed against fraudulent traders) the bankrupt was a criminal; but, with the amelioration and extension of these laws, the bankrupt is any person who is insolvent or has done any of the acts (called acts of bankruptcy) which the law provides shall entitle his creditors to have his estate administered for their benefit, such as the making of a general assignment, the making of a transfer of his property actually or constructively fraudulent, etc. * * *

"A trader or any person who becomes insolvent."
(Emphasis added.)

Commodore was at no time judicially declared bankrupt. Neither was it placed in the hands of a receiver appointed by a court. Therefore, it cannot bring itself within the provisions of Section 107(d)(2)(A)(i) of the Internal Revenue Code. Nevertheless, it was, in the critical years under consideration, insolvent, and its properties

were being administered under the supervision of Pacific, for Pacific's benefit. Said condition was one "resembling in many respects" bankruptcy or receivership. It was "somewhat like," or "having a general likeness" to the state of being actually bankrupt or the state or condition of being in the hands of a receiver.

The Tax Court has found as a fact that Pacific was in a position to foreclose its deed of trust on the hotel and furnishings at any time. It forbore to do so because it was keeping a close and constant check upon Commodore's operations, and was aware that all of Commodore's available revenues were being turned over to it to be applied on the indebtedness. The Tax Court further found that Pacific would not have shown such forbearance had the authorized salaries been paid. Commodore, in short, was a debtor with its back to the wall. Actually, its continued operations were at the sufferance of Pacific. Petitioners find it difficult to conceive of a condition or event (short of judicial declaration of bankruptcy) more closely resembling bankruptcy or receivership. For all practical purposes, Commodore was in the hands of its principal creditor, and was operating subject to its close supervision and control.

The respondent's Regulations 111, Section 29.107-3, provide that "back pay" shall include compensation which would have been paid but for the intervention of bankruptcy or receivership of the employer, or any other event determined to be similar in nature under the Regulation. Said section further provides that "as to what constitutes bankruptcy and receivership proceedings, see Section 29.274-1." The latter section describes what shall constitute bankruptcy and receivership proceedings for purposes

of the assessment provisions of Section 274 of the Internal Revenue Code (26 U. S. C. A., Sec. 274). Since that section describes actual bankruptcy and receivership proceedings, it is not determinative of what is *similar in nature* to such proceedings.

Section 29.107-3 then states that an event will be considered similar in nature to bankruptcy and receivership only if:

- (a) the circumstances are unusual;
- (b) they are of the type specified in the statute;
- (c) they operate to defer payment of the remuneration for the services performed; and
- (d) payment, but for such circumstances, would have been made prior to the taxable year in which received or accrued.

No further description of what is an event similar in nature to bankruptcy or receivership is afforded by the Regulations.

What has already been said establishes, we submit, that the circumstances existing in the prior taxable years operated to defer payment of the salaries and that the payments, but for such circumstances, would have been made in the earlier years. To use the words of the Tax Court [Tr. 96]:

“* * * by their forbearance to deplete corporate funds by salary payments petitioners’ (*sic*) officer-shareholders displayed a prudence *clearly indicated as necessary by existing circumstances.*” (Emphasis added.)

Implicit in this statement of the Tax Court is the conclusion that the existing circumstances operated to defer payment and that, but for their existence, the payments would have been made in the years in which the services were rendered.

Moreover, it would appear to be indisputable that the existing circumstances were unusual. Indeed, the Tax Court does not indicate otherwise. Financial distress is not a usual characteristic of business, nor is it usual for corporate officers to render services without current compensation.

There remains, in the light of the respondent's Regulations, only the question of whether or not the circumstances were of the type specified in the statute. The Tax Court decided this issue adversely to the petitioners. In this the Court erred.

A judicial declaration of bankruptcy and a judicial appointment of a receiver are events which, in the law, can be defined more or less exactly. What constitutes an event similar in nature to such events is not so readily susceptible to definition. Nevertheless, the facts of this case present a situation so closely akin to actual bankruptcy and receivership that the similarity cannot be escaped. Indeed, only the element of judicial declaration was lacking.

Because neither the statute nor the respondent's Regulations define precisely what events are similar in nature to bankruptcy or receivership, it is necessary to consider what the statutory language was intended to accomplish. Section 107(d) of the Internal Revenue Code is a relief provision. It provides, in effect, that if a salary earner does not, for specified reasons beyond his control, receive

his compensation in the year in which he renders services, but later receives that compensation, he shall not be required to pay an income tax on such compensation in the year of receipt greater than he would have had to pay had he received the compensation in the earlier years. (Indeed, the tax payable may, because of deductions, actually be *less* than it would have been in the years in which services were rendered.) The section permits the computation of the tax on such receipts at rates, and upon a basis, different from that otherwise prescribed. Because the section is a relief provision, it must be liberally construed to effectuate the objectives sought by the Legislature. Mertens, *Law of Federal Income Taxation*, Vol. 1, page 71; *Keeble v. Commissioner*, 2 T. C. 1249 (1943).

In the *Keeble* case, *supra*, the Tax Court was called to interpret Section 107(a) of the Internal Revenue Code (26 U. S. C. A., Sec. 107(a)). The Commissioner of Internal Revenue contended, in that case, that Section 107(a) was a provision granting an exemption from tax and that it should, therefore, be strictly construed. The Court rejected the Commissioner's argument, saying in part:

"The statute is remedial, granting relief to those coming within its terms. A remedial statute should be given a rational, sensible construction and one which will 'give the relief it was intended to provide.' *Bonwit Teller and Co. v. U. S.*, 283 U. S. 258; *F. Harold Johnston, Executor*, 33 B. T. A. 551; *Michel J. A. Bertin*, 1 T. C. 355. 'Common sense interpretation is the safest rule to follow in the administration

of income tax laws,' *Rhodes v. Commissioner*, 100 F. (2d) 966; and 'a desire for equality among taxpayers is to be attributed to Congress, rather than the reverse.' *Colgate Palmolive Peet Co.*, 320 U. S. 422."

All of the subsections of Section 107 of the Internal Revenue Code are directed toward the same general objectives, and should be similarly construed. Therefore, Section 107(d) is entitled to the same liberal interpretation as has been accorded Section 107(a).

If petitioners have brought themselves within the reasonable meaning of Section 107(d), they are entitled to prevail in this proceeding.

The provision was first introduced in the House of Representatives as Section 113 of the Revenue Act of 1943 (H. R. 3687, 78th Cong., 1st Sess.). As introduced, it provided a special method for computing tax only on amounts of back pay resulting from violations of the National Labor Relations Act and the Fair Labor Standards Act, or retroactive wage increases authorized by the National War Labor Board. In other words, as originally introduced, it covered generally only wage adjustments of the type described in Section 107(d)(2)(B) of the existing statute.

The House proposal was eliminated in its entirety by the Senate Finance Committee. The following explanation for said action was given in the report of the committee (Senate Report No. 627, 78th Cong., 1st Sess.):

"The House adopted a provision relating to the taxes on back pay received by an individual for serv-

ices rendered in a prior year because of alleged unfair labor practice under the National Labor Relations Act, or a violation of the Fair Labor Standards Act, or a retroactive increase approved by the National War Labor Board. Your committee was unable to agree with this provision because of its limited application and it has, therefore, been omitted from the bill.”

Section 107(d) in its present form was added to the Revenue Act of 1943 by Amendment No. 30 of the Conference Committee. In other words, the Conference Committee agreed that the provision should be broader than had been originally proposed in the House. The statement of the Conference Committee does not furnish any guidance for the determination of the problem here presented.

In view of the clearly expressed intention of the Congress that the section should extend to cases beyond those originally contemplated by the House, and in view of the fact that the provision is remedial in nature and should be construed to accomplish fairness and equality among taxpayers, the interpretation adopted by the Tax Court in this case is erroneous.

B. The Control Exercised by Pacific Over the Operations of Commodore Was Sufficient to Satisfy the Requirements of Section 107(d) of the Internal Revenue Code; and the Deferment of Payment of the Salaries Was Not the Result of a Voluntary Restraint.

Reference has already been made to the Tax Court's finding that there existed in this case a *factual necessity which restricted Commodore's freedom of action*. Notwithstanding this finding, the court concluded that the failure of Commodore to pay the salaries in the earlier years was the consequence of a restraint voluntarily imposed. The conclusion is obviously contrary to the finding. If there was, as a matter of fact, a restriction upon the ability of Commodore to pay, it must follow that the failure to pay was not the consequence of any voluntary action.

The Tax Court ruled that such factual necessity was insufficient to satisfy the requirements of Section 107(d). The court concluded that the control required by the statute is that which is vested in someone other than the corporate officers, and legally enforceable without reference to them. In support of its conclusion, the Tax Court cited *Kenny v. Commissioner*, 4 T. C. 750 (1945). In that case a creditor, as a condition of loaning further monies to a corporation, included in the written loan agreement a requirement that the amount of salary currently payable to a specified corporate officer should not exceed a certain sum, which was less than the officer's authorized salary. When the officer received the difference in a later year, after the restriction had been lifted, he com-

puted his tax in the manner authorized by Section 107(d) of the Internal Revenue Code. The Tax Court upheld his right to do so.

There was no finding by the Tax Court in the *Kenny* case that the financial condition of the debtor corporation was unsound or precarious. For all that appears in the court's findings of fact and opinion, the corporation may have been entirely solvent. As a matter of fact, it is not unusual for lending institutions, as a condition of loaning money, to impose restrictions upon the expenditures of the debtor. The imposition of such restrictions is not limited to insolvent borrowers.

It is apparent that the decision in the *Kenny* case does greater violence to the respondent's conception of the statutory purpose than could ever result from a decision in favor of the petitioners in this case. It is true that, in the *Kenny* case, there was a contractual agreement by the employer not to pay the full authorized salary. To this extent, the normal practice of the corporation was interfered with. But as has already been suggested, there was nothing to indicate that the employer was insolvent or otherwise unable to pay the full salary.

Contrast that picture with the one here presented. Here, the employer was for all practical purposes bankrupt. It was in default upon its indebtedness; its only income producing assets were subject to foreclosure at any time; and the payment of authorized salaries would merely have aggravated this distressed condition. Langer and Lindsey even had to advance moneys of their own to the cor-

poration, in order to forestall action by the creditor. Certainly Commodore was in a condition more nearly approximating bankruptcy or receivership than the employer in the *Kenny* case.

Petitioners have no quarrel with the result in the *Kenny* case. Nor does the respondent, for he has acquiesced in the decision. 1945 *Cumulative Bulletin*, page 4. But if Mr. Kenny was entitled to the relief afforded by Section 107(d), certainly it cannot be denied to the petitioners in this case. The circumstances which existed here, and the actual control exercised by Pacific, were, it is submitted, the very type intended to be covered by the section.

Even if the Tax Court's premise, that there must exist a legally enforceable control in another, is correct, certainly that control existed here. Though Pacific exacted no written agreement from Commodore that it would not pay the authorized salaries, it was possessed of an effective legal control which was every bit as potent as an express written restriction. Pacific held a deed of trust upon Commodore's income producing assets as security for a substantial indebtedness. Had the authorized salaries been paid to Langer and Lindsey, the defaults in payment of the obligation would have been aggravated, and Pacific would undoubtedly have instituted foreclosure proceedings. The Tax Court was of the opinion that Pacific's forbearance from foreclosure would not have continued had the salaries been paid.

What more effective, legally enforceable control can there be than this?

Conclusion.

It is respectfully submitted that the Tax Court erred in its legal conclusions expressed in this cause. It erred in determining deficiencies against the petitioners, and in failing to find that petitioners Lindsey and wife had overpaid their federal income taxes for the year 1944. Accordingly, it is submitted that the decisions of the Tax Court should be reversed.

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